A Work Project, presented as part of the requirements for the Award of a Masters Degree in Finance from the NOVA School of Business and Economics

Shareholder Wars at Banco Português de Investimento

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A Project carried out under the supervision of:

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January 2017

Abstract

Title: Shareholder Wars at Banco Português de Investimento

This case study aims to describe the impacts created on Banco Português de Investimento's governance when supervision of the largest 120 European banks switched from National Banks to the European Central Bank. When this occurred, BPI was informed that its exposure to Angola, through one of its subsidiaries- *Banco de Fomento Angolano*-, surpassed the limit of the large risks imposed by the ECB in €3 billion. The urge for solutions to avoid daily sanctions by the ECB triggered a fight for control between the bank's key shareholders, La Caixa and Santoro Finance, given that Isabel dos Santos, daughter of Angola's president, was a key shareholder both in BPI and in *Banco de Fomento Angolano*- through a company named Unitel. The Governance of the Bank comprising a shareholders voting rights limit, the number of Shareholder's evolution, the negotiation process that included a Portuguese Government intervention, the sale of part of BFA to Unitel and the tender offer launched by La Caixa in order to control BPI are discussed in detail to provide the reader all the information required to assess on whether or not all good Governance principles were followed throughout the process.

Keywords: Corporate Governance, Banking Supervision, Banco BPI, Angola, Isabel dos Santos, La Caixa.

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Shareholder Wars at Banco Português de Investimento

"The heedlessly application of a rule, which I do not discuss, will oblige us to be expelled from Angola. Until today I have not yet heard any words from anyone with responsibility in Portugal that worried with this. [...] From the former Government, zero, nor even from the ex-Prime-Minister nor from the ex-Finance Minister. [...] My discontent is not with the European institutions."

Fernando Ulrich, CEO, BPI[1]

In December 2014, the European Central Bank (ECB) announced that the Republic of Angola had not been included in the list of 17 States or territories in which financial institution supervision could be recognised as equivalent to the one conducted by the European Union. Under these rules, European banks can not be exposed to sovereign debt of these countries in more than 25% of their equity value.

These were shocking news for *Banco Português de Investimentos* (BPI), a Portuguese bank whose Angolan subsidiary, *Banco de Fomento Angolano* (BFA), would make it surpass this limit in €3 billion. If a solution for such exposures could not be reached by April of 2016, BPI would have to pay €3.5 million in daily fines[2].

This could not have happened at a worst moment. The bank was facing significant challenges at its home country market, who had recently been bailed out by a troyka of financial backers (ECB, International Monetary Fund and European Union) while facing a war amongst its main shareholders. Two months after ECB's decision, BPI's key shareholder La Caixa decided to launch a tender offer in order to acquire all outstanding shares[3].

One of the other key shareholders, Santoro Finance (holding 18.8% of BPI) opposed La Caixa's bid (see **Exhibit 1**). The firm was controlled by Isabel dos Santos, daughter of Angola's

President, who also controlled Unitel- owner of 49.9% of BFA[4]. She had interests on both sides of the problem and the existing voting rights limit gave her about the same controlling power as the one La Caixa had in BPI. Now, the bank needed to find a fast solution to avoid any sanctions from ECB and, at the same time, allow for all key shareholders to protect their interests.

At a time when a required €12 billion equity issue[a] that accommodated this exposure in capital buffer was impossible, would Isabel dos Santos concede her power in Portugal in exchange for the control of the Angolan bank?

History

In October 1981, *Sociedade Portuguesa de Investimentos* (SPI) was created under the initiative of Artur Santos Silva. With the aim of providing finance to private investment projects, contribute to the re-launching of capital markets in Portugal and to the modernization of Portuguese enterprise structures, SPI had a diversified shareholder base, composed by over 100 shareholders, mainly Northern Portuguese business leaders.

Santos Silva was nominated in 1968 as general director of *Banco Português do Atlântico*, a position he left in 1975 when he was appointed as State Secretary of the Portuguese Treasury. After leaving the Government, he became Vice-Governor of the Bank of Portugal from 1977 to 1978.

In 1985, SPI became an investment bank, capable of accepting deposits and granting loans. The investment bank was given the name *Banco Português de Investimento* (BPI). One year later, in the same year that Portugal joined the European Economic Community, SPI went through an IPO[b], and was quoted on the Portuguese stock market[5,6].

The rise of a Financial Institution

In August 1991, BPI, backed by Itaú Bank, won the privatization process of the commercial bank *Banco Fonsecas e Burnay.* In 1995, BPI went through a reorganization process which created a banking holdings society, named BPI SGPS, which substituted SPI in the Portuguese

[a] Given that the Risk Weighted Assets weighting for this exposure started to be computed at 100% instead of 0% or 20% (as sovereign debt is), the €12 billion equity raise would allow BPI to maintain the more than €3 billion exposure to Angola, since it would be lower than 25% of its equity book value.

[b] Initial Public Offering

stock market. This was the moment in which *La Caja de Ahorros y Pensiones de Barcelona* (La Caixa) along with the German Insurer Allianz became shareholders in the bank.

In 1996, BPI won the privatization process *Banco de Fomento Exterior* (BFE). BFE was one of the first ever created Portuguese Investment Banks. Established by the Portuguese Government in 1959, it had acquired *Banco Borges & Irmão* in 1991, however working as two separate entities. Winning the privatization process helped BPI to court the remaining 35% of BFE's shares, held by minority shareholders.

The year of 1998 was the year of the conclusion of all merger processes. The result was the disappearance of the 3 banks' brands belonging to BPI's group and the consequent rebranding of all branches under just one name: *Banco BPI*. BPI Group now had two major activities under two different names: *Banco BPI*- the Commercial Bank- and *BPI Investimentos*- the Investment Bank[7].

Main Activities

Investment Banking

Since the creation of SPI, BPI always had a strong Investment Banking activity component. In 1991, a decade after the creation of SPI, BPI was already market leader in Investment Banking in Portugal. In 2000, this bank's division had a strong focus on Corporate Finance and other areas including Project Finance, Brokerage, Research, Debt Capital Markets, Private Banking, Asset Management, Investment Funds, Pension Schemes, Venture Capital and Private Equity[8]. In the same year, *BPI- Investimentos* registered net profits of €28 million euros (18% of the group's overall results). In 2006 and 2007, the division improved its performance, with an average of €24.8 million of net profit. However, in 2008 due to the recession, Iberian capital markets suffered a 47% decrease in trading volumes which hit *BPI- Investimentos* (that year's net profit was €10.4 million). Still, between 2007 and 2009, it had 24.5% of Portuguese Corporate Finance market share[9].

Commercial Banking

In 1999, after all acquisitions were completed, BPI's Commercial Banking unit was split into Individuals Banking, Corporate Banking, Institutional Banking (for Municipal and Institutional clients) and in Other Activities that included Leasing and Factoring businesses. In 2005, BPI's group had €22.2 billion in total customer resources, €21 billion in its loan portfolio, a return on shareholder's equity of 23.5% (21.8% in 2000) and a return on average total assets of 0.9% (0.8% in 2000)[10].

2008 was the first year that BPI saw the impact of financial crisis, with net profits falling 57.7%. BPI's portfolio differed from its peers, as its exposure to real estate and consumer credit were lower than most Portuguese Banks (see **Exhibit 12 to 21).** Instead, the search for high yield investments resulted in a high exposure to sovereign debt, mostly Greek and Portuguese. BPI was then obliged by the European Banking Authority to issue €1,5 billion in Contingent Convertible bonds (CoCos), booked by the Portuguese Government (with money from the *troika* intervention), to provide capital buffers[11,12].

The major difference between a CoCo and a regular Convertible Debt[13] security lays on their contingent convertible feature. In the case of Convertible Debt, the holder converts in the upside- when the equity value is superior than the debt repayment. In the case of BPI's CoCos, the Portuguese Government would automatically convert them into common equity in the downside- from the moment when BPI's Common Equity Tier 1 ratio fell below 7%. These were fully repaid until 2014 with no need for conversion (see **Exhibit 22).**

Africa: the sweet escape

Angola

In 1990, BFE opened a representation office in Luanda, the capital of Angola. Three years later, aiming to reinforce its representation on the country, BFE opened an own branch in Luanda with a starting capital equivalent to $4 million. This was the starting point for the beginning of the bank's activity in the country. When BPI bought BFE in 1996, a strong expansion plan was laid out. The aim was to expand its activity in a country with several business and development opportunities[14].

In 2002, BPI decided that its representation in Angola could be improved. Transforming all the Angolan branches it had at the time, the result was a newly created entity: *Banco de Fomento Angolano* (BFA). Owned 100% by BPI and having a market share of 25% in 2002, the mission of BFA was to support Angolan businesses in their regular activities and to be the the financing partner when such firms decided to expand their activities internationally.

BFA delivered sound results since its inception to BPI. Growing from 230,000 clients in 2005 to 553,000 clients in 2008[11], its profits increased from €69.7 million (2005) to €140.6 million.

Also in 2008 BPI sold 49.9% of BFA to Unitel, an Angolan telecommunications firm, in which Isabel dos Santos is a key controlling shareholder. One of the reasons disclosed was to prompt

BFA growth with the help of a strategic shareholder of the market in which it operated. On the other hand, there were also pressures from the Angolan Government that wanted local banks to have connections with local companies. Unitel paid $200 million right away and $275 million in eight annual installments, from 2009 to 2016. Afterwards, BFA was very important to offset some of the losses suffered by BPI during the financial crisis. The best example occurred in 2013[15], when BFA contributed with €88 million to BPI SGPS net profit while the group's net profit was €66.8 million (meaning that without this contribution the group would have reported a loss in that year) (see **Exhibit 22).**.

Mozambique

In 1993, *Banco de Fomento de Moçambique* (BFM) started its business with a branch and an agency in Mozambique's capital, Maputo, belonging to BFE. In 1996, BFE's acquisition helped BPI reinforce its presence in the country developing commercial banking activities, something that had not been done before, since the bank's presence in Mozambique was limited to consulting services related to investment banking. In 1998 the branch was transformed into a Mozambique-law bank, enabling the merger of BFM with *Banco Comercial e de Investimentos* (BCI) in 2003. Since then BPI owns 30% of *BCI Fomento* (BCIF), the newly-created entity, along with *Caixa Geral de Depósitos*[c] that has a 51% equity stake. Its contribution to the overall profit of BPI SGPS ranged from €1,8 million in 2005 to €10,6 million in 2014. In 2015, BCIF had a total of 163 branches in Mozambique and contributed to BPI SGPS profit with €9,4 million[14,15] (see **Exhibit 22**).

The eternal perfect bride

Strategic visions and family businesses

With the turn of the millennium, two of the major Portuguese Banks tried to merge: *Banco Espirito Santo* (BES) and BPI. BES' CEO, Ricardo Salgado, and Artur Santos Silva saw a good opportunity to take advantage from two over dimensioned structures in order to build the biggest Portuguese Bank. However, in March of that year, a joint official release was issued stating the end of the merger talks. The official response stated that different strategic reasons were behind the deal's collapse, pointing that the separate entities development would be

[c] Caixa Geral de Depósitos is a Portuguese State owned bank

beneficial. The separation was allegedly initiated from the Espirito Santo side who feared that the family-owned group would loose control in the new entity[18]. From BPI's side, Artur Santos Silva pointed to the lack of willingness and availability to build a joint project as the reason for the break up. Also, it was noted that BPI had serious corporate governance misgivings about BES- which later in 2014 turned out to be the reason for BES' collapse[19]- pointed as the main reason for the merger failure. One of the final comments about the possible merger came from Fernando Ulrich, who ended saying: "I am not available for an Espírito Santo project"[19]

Stockholm syndrome

In March 2006, *Banco Comercial Português* (BCP) tried to acquire BPI. At that time, BCP offered €5,7 euros for each BPI share. However, even though BCP reviewed their offer- valuing BPI in €5,320 million with a premium of 12.35%- it was promptly declined since the target considered the offer as hostile. Artur Santos Silva, in a statement named "BPI vs. BCP- value creation versus value destruction"[20], referred that the offer considerably undervalued BPI and did not favor shareholders' interests nor clients or employees. Fernando Ulrich, in his own style, concluded by saying in a press conference that Paulo Teixeira Pinto (BCP's CEO) was "very bold for a person that was in the banking management for less that one year".

However, like the hostage that ends up liking the kidnapper, on 25th October 2007, BPI proposed a merger with BCP, at a time when BCP was suffering an internal governance crisis. The offer was based on two major assumptions. First, given the first symptoms of an approaching financial crisis and the exposure of the Portuguese financial system to the real estate market, the merger could accelerate the growth rates of both businesses, expand into new markets and create cost synergies. Second, it was deemed that BPI's good governance rules and strategic goals, if implemented on BCP, could bring more value to both shareholders and stakeholders. At that time, the exchange ratio would be 2 shares of BCP to 1 of BPI, increasing the new entity's equity to a total sum of more than €2,5 billion. Once again, after discrepancies between both boards control demands, negotiations came to an end on the 25th November 2007. BPI was trading at a price of €6,51 per share and BCP at €3,19 per share.[22] (see **Exhibit 24).**

Shareholders base and Corporate Governance

Original investors

Sociedade Portuguesa de Investimentos was originally financed and supported by a group of 100 investors, in its majority composed by some of the most important Portuguese business owners in the North of Portugal. This group included Americo Amorim- owner of Corticeira Amorim- with a long history in the Portuguese financial system and Salvador Caetano- owner Toyota's distributor in Portugal. This group of original investors was dissolved when, in the late 1980s, Santander launched a successful hostile bid for *Banco Comércio e Indústria,* which at the time was the retail arm of BPI. The process split the group as there was an agreement made between Santander and some of the major shareholders, who decided to break up the alliance that they had previously made[23].

BPI's wonder trio

BPI's reorganization process in 1995 led to the entrance of the Catalonian Bank *La Caja de Ahorros y Pensiones de Barcelona* (La Caixa) along with the German Insurer Allianz in the society's equity**.** These shareholders joined the Brazilian bank Itaú to create a strategic alliance. In 1999, Allianz, La Caixa and Itaú had respectively 8.9%, 12.4% and 12.5% of the bank's equity (see **Exhibit 1)**.

Allianz saw BPI as a strategic partner in order to sell its insurance products through the bank's retail channels. This strategic partnership was extended when, in 2006, Euler Hermes (an insurance company owned by Allianz) and BPI bought COSEC- *Companhia de Seguros de Créditos-,* one of the biggest Portuguese credit insurance providers. BPI also has a participation of 35% in Allianz Portugal. La Caixa saw BPI as a well-established partner that covered the Portuguese market, eliminating the need for having a branch of the Spanish bank in the country. Itaú was in a similar situation as La Caixa, having a representation office in Lisbon that latter were turned into its European headquarters.

Both acquisition attempts targeting BPI became proof tests for the resistance and support that the three key shareholders had, especially in the managing board. More specifically, when BPI was subject to he first hostile attempt from BCP, all trio members refused to accept the advantageous offer, stating its confidence in the management that had previously said that the bank would be much better on its own. Also, they signaled their trust by acquiring more BPI shares.

Also, these key shareholders were very supportive of the major change in the Management Board of BPI's history. Artur Santos Silva, because of the statutory limit that BPI has related to the CEO's age limit, had to cease his executive functions. From that point onwards, he remained the bank's Chairman (a role that he had combined while being CEO). In his place Fernando Ulrich was appointed. Ulrich was one of the Vice-Presidents of SPI since 1983, having previously worked in the international department of *Banco Pinto & Sotto Mayor*. He had also been the chief of staff of the Finance Minister and a financial journalist for *Expresso*. When BCP tried to acquire BPI, one of the conditions was to appoint a new CEO for the newly-created entity, something that BPI's shareholders did not agree with given the trust they deposited in Fernando Ulrich.

The Angolan Princess

Following the failure of the merger with BCP, the bank remained with 10% of BPI's equity. Isabel dos Santos bought this position in 2008, through a holding company named Santoro Finance, becoming one of the key shareholders.

Isabel dos Santos, daughter of the Angolan President José Eduardo dos Santos (who came to presidency in 1979), made her first investment in Portugal in the energy sector, together with one of the first BPI's shareholders, Américo Amorim. Today, her investments in Portugal amount to approximately €3 billion, being the most famous ones Galp Energia[d], NOS SGPS[e] and BPI[25].

It only takes two to Tango

In 2012, Itaú decided to leave Portugal and sell its BPI shares. Two years before, Itaú had decided to move its European headquarters from Lisbon to London, since the drop in Portugal's rating in 2007 had limited the financing opportunities of financial intermediation through the issuance of international bonds from Portugal. Therefore, bonds had to be issued in Brazil in order to finance European operations, something that went against the European project's interests. According to Carlos Câmara Pestana[26], the Portuguese who presided Itaú, the partnership between the Portuguese and the Brazilian bank no longer made sense, given the headquarters switch and the intention to continue European operations.

Even though there was a preference to sell the 19% position to Portuguese investors, La Caixa ended up acquiring it for €93 million (€0.5 per share). Afterwards, La Caixa sold part of this percentage to Santoro Finance, which ended up with 19.5% of BPI SGPS. The Spanish shareholder now owned 46.2% and Allianz remained with 8.8% of the entity's capital.

[d] Galp Energia is the biggest portuguese producer of petrol and natural gas.
[e] NOS SGPS is one of the largest Portuguese telecommunications and TV providers.

Amongst Portuguese shareholders, Violas Financial group was the one with more BPI shares with 2.2% of the group's equity (see **Exhibit 1**).

Corporate Governance

Since BPI's inception, the group has been known for its set of good governance principles and practices. The main goal is to ensure that management acts in the best interests of all Shareholders and other Stakeholders. Some of the pillars include the adoption of best market practices regarding the communication of any group related information, the value creation as the management's principal objective, the independence of executive management and the outmost commitment to the standards of ethical and professional conduct. In fact, BPI was one of the first Portuguese entities to release, together with its annual report, a Corporate Governance Report. This has occurred since 2000, a time when it was not yet mandatory for quoted companies to disclose such information. The main features of this report include the shareholder structure, governing bodies and committees, internal organization (as the reporting of irregularities and the internal control and risk management), remuneration of the company's governing and management bodies as well as an analysis of compliance with the corporate governance code adopted. Regarding the number of independent non-executives,

BPI Group's governance model comprises the Latin model structure, one of the three comprised in the Commercial Companies Code. In particular, the Board of Directors is responsible for the firm's management. This Board includes an Executive Committee composed by independent professionals from any shareholders' or specific interests. The Consultative Bodies of the Board of Directors comprise 4 main constituents:

- Financial Risks Committee: monitors the policy management of all financial risks, as the credit risks, the Bank's activities and the management of pension funds;
- Corporate Governance Committee: responsible for supporting and advising the Board of Directors as for the improvement of the governance and oversight model and addressing concerns related to social responsibility, ethics, professional conduct and environmental protection;
- Nominations, Evaluation and Remuneration Committee- provide opinions related to nominations for the governing bodies, for the choice of Directors appointed to the Executive Committee and to exercise the functions envisaged by the rules of the Bank of Portugal related to remuneration policies.

These Consultative Bodies are solely composed by non-executives, something that does not happen in every other bank, in which these contain members of the Executive Committee. Composing these Bodies, one may find at least one independent member in each one (see **Exhibit 25 to 26)**.

Besides these Consultative Bodies, other oversight groups are part of the Group's Governance model. The Supervisory Board is responsible for overseeing management's compliance with the Law and the company's Statutes, verifying the accounts, supervising the independence of the Portuguese Statutory Auditor and the external auditor and also evaluating the latter's work. The General Meeting is attended by all Banco BPI shareholders, who deliberate on the issues such as the election of the governing bodies, the approval of director's reports, the annual accounts, the distribution of profits and capital increases. The Remunerations Committee, appointed by the General Meeting, fixes the remuneration of the officers, based on the opinion of the Nominations, Evaluation and Remuneration Committee (see **Exhibit 25).** Lastly, the Company Secretary is appointed by the Board of Directors whose responsibilities are mainly related to performing the functions comprised in the Portuguese law and others attributed by the Bank[14].

Black gold turns into toxic lead

Supervision wake up call

On 4th November 2014, the supervision of the 120 largest European banks switched from national central banks, as the Bank of Portugal (BoP)[27], to the ECB. In December of 2014, the European Commission announced that the Republic of Angola had not been included in the list of 17 States or territories in which financial institution supervision could be recognized as equivalent as the one made by the European Union. While the BoP considered BPI's exposure to BFA as sovereign debt with little or no risk, this was no longer accepted under ECB rules, which saw it as junk. In practical terms, this decision meant the end of zero or 20% risk weighting for Capital ratios and Risk Weighted asset computations, now considered at 100%. The first impact was the decrease of BPI's Core Tier 1 capital ratio by one percentage point to 8.6% (the required minimum by the ECB is 7%). The second effect was that this exposure would no longer be exempt from the large risks exposure limit included in European regulations. BPI was now exceeding this limit in approximately €3,000 million. The bank's first reaction was to convey its conviction that the maximum loss arising from that exposure would be €394 million- the book value of the 50.1% participation in BFA's capital- which placed it under the limit of large risks. BPI submitted a proposal to ECB[28] in order to apply the equity method for prudential purposes to BFA- allowing to reduce the maximum loss from the exposition to €394 million- something not accepted by the European entity. Therefore, one of the main priorities for 2015 was to find alternative solutions for the situation, since the EU had set a deadline for April of 2016.

Voting rights limits

Given the broad shareholder base that constituted SPI, one of the original bylaws was a voting rights limitation. This meant that even if a shareholder held more than a certain percentage of the firm's equity, its voting power would never surpass that same percentage. As of 1999, this percentage was 12.5%, being increased to 17.5% in 2006 (when BCP tried to acquire BPI) and to 20% in 2010. For example, even though La Caixa in 2015 held 44.1% and Santoro Finance held 18.6% of BPI's equity, with a voting rights limit of 20% their decision power was about the same. The major aims of this bylaw were to maintain a broad number of key shareholders with enough strategic power, not allowing one or two that held substantially more equity to control all the major decisions according to their interests.

Shareholder wars

On the 17th of February of 2015, La Caixa launched a tender offer to the ownership of all BPI's outstanding shares it did not own. At a price of €1.329 (closing price on the day before was €1.04), the tender offer had two main conditions: the elimination of any voting rights limits, which required 75% of the shareholder votes, and the acquisition of at least 5.9% of the overall shares outstanding (the minimum for La Caixa to have BPI's control).

Isabel dos Santos, responded to the tender offer by issuing a statement proposing a merger between BPI and BCP, in which she had interests a through Sonangol[f]. The statement was generally considered by the press as a disguised way of saying that she would be willing to sell her BPI shares, although at a significantly higher price[31].

On 5th March, BPI's board of directors rejected La Caixa's offer. The board believed that BPI's shares were worth €2.26: €1.12 relative to the domestic activity, €0.92 for the international

[f] Isabel dos Santos was nominated in 2016 for the presidency of the Executive Committee at Sonangol, an Angolan State company that explores petrol and natural gas in the country and that, on the 31st December 2014 held 19,44% of BCP.

activity and €0.22 to account for half of the synergies that La Caixa estimated for this acquisition.

Three months later, in a shareholders' meeting, Santoro Finance submitted a motion to eliminate the limits on voting rights[30]. Voting against its own proposal, Santoro made use of the voting rights limit to derail one of the takeover's condition. La Caixa, on the following day, announced that the takeover plans had failed, precisely because one of the conditions that would make it successful would not be met. In the following shareholders' meeting, on February of 2016, Santoro Finance making use of the "armour-plating effect" rejected once again a proposal made by the board of directors of BPI's to eliminate the statutory limit on votes. Even though the voting attained 63.08% of favorable votes, Santoro's decision to vote against was crucial in order for it not to attain the 66.6% minimum limit in order for the decision to be approved.

Back to Angola

Previously, on 30th September 2015, BPI's board of directors approved a spin-off of BPI, in a way that would separate the bank from BFA and avoid the large risks limit imposed by the ECB. The solution would be to create another separate holdings company that would comprise BPI's participation in BFA, in which BPI's shareholders would own the same percentage as they had in the bank. However, not all shareholders (as La Caixa) agreed with this solution, as they did not want to be directly exposed to Angola. On the other hand, at the start of 2016[31], Unitel, the other major BFA shareholder, proposed an acquisition of 10% of BFA's shares for €140 million, an offer that was promptly rejected by the board of BPI. Several reasons supported the rejection. Firstly, BPI did not want to loose that much equity for that price in a firm that had contributed a lot for the enhancement of its profits. Secondly, Fernando Ulrich said that the spin-off was much more advantageous for BPI's interests than selling part of BFA. On top of this, *Portugal Telecom* Ventures, a firm belonging to one of the largest Portuguese Telecommunications provider that had already suffered governance problems in the BES case, was also a shareholder of Unitel (with 25%). As it had not been notified of Unitel's proposal to acquire part of BFA and was against it, it had submitted a complaint that was approved by the Court of Trade of Paris, creating a problem that Ulrich wanted to avoid[32].

Can't keep my hands to myself

As if the Portuguese Government did not have enough problems to deal with, it also determined that the case with BPI was a matter of National interest. Thus, in April of 2016 the Government created a diploma aiming to solve the situation of the voting rights limit. It created a law only applicable to financial institutions with this bylaw, in which the maintenance or elimination of voting rights limits had to be voted in a shareholders' assembly every five years. Also, it stated that institutions that had such voting rights limits in 2016 were obliged to gather its shareholders and include such voting in a shareholders' meeting until the end of the year, otherwise, voting rights limits on these institutions would be automatically eliminated. Also, if this type of voting occurred, no voting rights limits would be exercised, meaning that, in the case of BPI, La Caixa would vote with 44.1% and would not limited to 20%.
Even though the Government justified this decision by saying that it was beneficial to attract foreign investment for the country, Isabel dos Santos stated that an historical and unparalleled decision had been taken which was obviously very beneficial for one part (La Caixa) of the conflict. With less weighting in terms of decision power, shares would obviously be worth less, beneficiating La Caixa which had presented in the year before a tender offer with a generally considered low offer price. The Government, in the words of Prime-Minister António Costa, responded by saying that the diploma on the first instance was approved because there was an agreement between La Caixa and Santoro, however ending up by having to be approved since the agreement was no longer on the table. This potential agreement that António Costa was referring to started to be talked after Portuguese newspapers disclosed that negotiations between La Caixa and Santoro had resumed, intermediated by the Portuguese Government, in which a potential solution would comprise the selling of Angolan's shares to the Spanish group and, in exchange, Unitel would acquire and keep the totality of BFA's shares[33].

The never ending tour

In the end, after several negotiations and suspended shareholders' assemblies- at a time when credit line of $440 million granted by La Caixa to Angolan's Government was being investigated by *Comissão de Mercado de Valores Mobiliários* (CMVM)[g]-[33], on September of 2016 in a shareholders meeting, a proposal presented by *Violas Ferreira* Financial to eliminate voting rights limits was approved[34]. However, this approval was not made to the initial proposal

[g] CMVM is the Portuguese Securities Market Commission. Constituted in 1991, it supervises and regulates securities and stock markets as well as the activities of those who operate in them.

presented by the board of BPI- the one under the diploma of the Government- since *Violas Ferreira* Financial had presented an injunction to the Government's decision, considering it to be illegitimate. This meant that Isabel dos Santos had conceded to abstain Santoro's vote because the voting rights limits were still in place. On the day before, the board of BPI had informed CMVM saying that it had sent a letter to Unitel proposing a sale of 2% of BFA for €28 million. The offer was contingent on the approval of the remaining shareholders as well as on the vote of Santoro to end the voting rights limits, something that eventually happened[35].

The ending of the voting rights limits was, under CMVM's opinion, a clear sign that now La Caixa had control over BPI. Now the Spanish group was obliged to proceed to an acquisition of the totality of the Portuguese group's capital since there is a Portuguese law that states that a shareholder holding of more than one third of another firm must launch a tender offer for the total capital[36]. La Caixa had previously obtained a waiver from CMVM given the voting rights limits. Previously, on April 2016, La Caixa had already stated an intention to acquire BPI shares at €1.113 per share, for a total valuation of €1,622 million. Also, it had requested ECB to suspend any sanctions (because the deadline had already passed), since it was actively working on a solution for the excessive risk concentration issue. Finally, on 13th October, the Board of Directors approved a tender offer by La Caixa at €1.34 per share. Even though Ulrich believed that BPI was worth €1.38 p/share, he considered the offer to be "friendly and at a good timing, since BPI could now take new challenges and opportunities in the banking sector". As a result, Edgar Alves Ferreira, the representative on the board of Violas Ferreira Financial, quitted since the shareholder was always against the offer.

Once again, a shareholders' meeting was called for 23rd November 2016, to approve the sale of 2% of BFA to Unitel- a proposal presented by BPI's board of directors. However, a proposal to suspend the meeting by La Caixa was approved. The argument for the suspension was based on the lack of formal approval by the ECB of this sale as to whether or not it would limit the exposure within European regulation. The largest Portuguese shareholder, *Violas Ferreira* Financial, raised a concern that the suspension was not due to the lack of ECB's approval but because La Caixa wanted to wait for the approval of the payment of BFA's dividends to BPI. Finally, on the 13th December 2016, the sale of 2% of BFA to Unitel was approved by shareholders in a meeting[37]. The ECB also issued a statement saying that there was no opposition to the transaction and that now BPI is under the large risks limit. Also, the National Bank of Angola approved the transaction.

Santos Silva's dilemmas

As Chairman of the Board of Directors, Santos Silva has a fiduciary duty with all shareholders. This means that his actions must attempt to favor everyone's interests. On practice, should BPI accept an offer below the fair price for BFA? If on one hand it helps to eliminate the problem, because the Angolan has on her hands the solution for the problem, on the other, doing it would favor one shareholder jeopardizing the others- not only La Caixa but all other smaller shareholders. Also, given that the transaction is made between related parties (Isabel dos Santos has interests in BPI and BFA), Santos Silva must set up an independent committee to oversee it. Moreover, there are always smaller shareholders that do not fully agree with the solution, given that they also want higher returns. This would create a major Corporate Governance issue, something that BPI always prided itself for avoiding when compared to its Portuguese peers. However, the imposition of heavy fines by the ECB, which would certainly harm every shareholder, urges for a solution. Therefore, there is a trade-off between following sound governance principles- and they can still be followed by setting up an independent committee to oversee the transaction- and the opportunity gain of not following them. Particularly, the life of the bank can be completely blocked, and now, when taking into account that Isabel dos Santos owns the majority of BFA's capital, BPI's position is more fragile, given that transparence of businesses made in Angola is not as ideal as it should be.
Concluding, the cost of giving up more money to Isabel dos Santos in exchange for not having to pay €3.5 million in daily fines seems an easy decision to take. However, given the bad reputation that it might bring because of the breached governance rules, Santos Silva must take into account all costs involved and decide for the least harmful solution for BPI's shareholders.

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TEACHING NOTE January 2017

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Shareholder Wars at Banco Português de Investimento

Overview

This case study aims to describe the impacts created on Banco Português de Investimento's governance when supervision of the largest 120 European banks switched from National Banks to the European Central Bank. Given that the Republic of Angola had not been included in the list of 17 States or territories in which financial institution supervision could be recognised as equivalent as the one made by the European Union, BPI was informed that its exposure to Angola, through one of its subsidiaries- *Banco de Fomento Angolano*-, surpassed the limit of the large risks imposed by the ECB in €3 billion. This subsidiary had been very important for BPI since it had enhanced over the past years its weak earnings due tot he struggling domestic market. The immediate response of BPI was to explain to the ECB that this exposure would have at maximum a loss of €394 million (the book value of BFA), something that was not accepted by the European authority. If a solution would not be found by April 2016, the bank would face €3.5 million in daily fines.

On top of this, BPI's shareholders were fighting for the institution's control. La Caixa, two months after the ECB decision decided to launch a tender offer to acquire all outstanding shares it did not own with two major conditions:

- a minimum of 5,9% of the outstanding shares would have to be bought;
- the existing voting rights limit of 20% would have to be eliminated.

While the first condition relied mainly on price agreements, the second was much more difficult to attain. One of the bank's bylaws stated that a single shareholder would have its decision power caped at a 20% voting rights limit, independently from the shares it could held. In practice, this meant that Santoro Finance, that held 18,8% of BPI, had about the same control as La Caixa with 44% of the outstanding shares. On top of this, Santoro Finance was controlled by Isabel dos Santos, daughter of the President of Angola, that also controlled Unitel- the other major shareholder of BFA with 49,9%. Therefore, she had interests on both sides of the problem, and, she would only be willing to accept a solution that would be very favourable for her pockets. This meant that she would only be willing to give up on her pivotal position on BPI in exchange for very favourable terms in BFA- as paying less to own a majority in BFA's capital in exchange for voting to eliminate the voting rights limits and concede the controlling power in BPI to La Caixa.

In Corporate Governance terms, this case illustrates two major problems. Even though BPI was known for its set of good governance practices, the voting rights limits along with this transaction between related parties constitute breaches that ought to be analysed in detail. First, when a voting rights limit is imposed, the principle of "one share, one vote" is being violated. Secondly, if Isabel dos Santos is obtaining a higher return that other shareholders of BPI, whether by paying less for BFA or by obtaining more money for her shares when La Caixa completes its tender offer, it also violates good governance principles (one should also not forget that La Caixa granted a $440 million credit line to the Republic of Angola in the wake of the negotiations).

Both sides of the problem need to be evaluated. The opportunity cost of not solving the problem is big; fines imposed by the ECB are huge and, if in place, will harm every shareholder. On the other hand, solving the problem may lead to breaking good governance principles, something that may harm the institution in the present and in future businesses, with potential fines from regulators. Therefore, and as a €12 billion capital raise is not a viable solution for the problem, the major question one should ask is: is it more advantageous to follow good governance rules and have a €3,5 million daily problem or find an alternative way and solve the problem by reducing the exposure to Angola?

Finally, La Caixa, after one failed tender offer that was rejected by BPI's BoD, launched a second one at a higher price (€1.34 p/ share). This offer followed the elimination of the voting rights limits in shareholders meeting- in which Santoro Finance abstained to vote- and anticipated the approved sale, also in a shareholders meeting, of 2% of BFA to Unitel by €28 million.

Conceptual Foundation and Teaching Objectives

This case study allows students to analyse how an institution that follows good Corporate Governance principles may see itself in a dead end, where sometimes breaching them is the only viable solution. Also, it prompts a discussion around the following teaching objectives:

1. To critically evaluate European banking supervision and understand the impact of regulatory frameworks.
2. To understand how financial institutions use accounting methods for their advantage when dealing with subsidiaries in foreign countries.
3. To evaluate the costs and benefits that may arise from Corporate Governance mechanisms.
4. To discuss how different shareholders' interests lead to the actions they may take according to their goals.

Suggested Student Assignments

1. **How does BPI's Governance Model fit into the Bank for International Settlements' Corporate Governance recommendations and how does it compare to its peers?**

The Bank for International Settlements' recommendations outline a set of principles that banks should follow regarding sound Corporate Governance matters. When comparing BPI's Governance model with these recommendations, one does not find major significant differences. For example, when it comes to the Board of Directors' qualifications, we see that the majority has previous experience in banking, ensuring the skills required to perform such positions. Also, the Executive Committee is solely composed by independent members. On the other hand, we see that a lot of the members of the Board of Directors connections to key shareholders of the bank, and, when evaluating their independence, we see that there is not a really good balance between those who are and those who are not. Regarding their compensation, we see that there is a committee responsible for it and that, the structure (with variable pay and a programme of long-term incentives) is aligned with BIS' recommendations, specially when it comes to managing their risk appetite. However, BIS recommends that banks should have a Committee dedicated to Ethics and Compliance, ensuring that the decision-making process is supported by appropriate means, where risks for the bank's reputation are considered and that compliance with internal rules, laws and regulations is ensured. One can see that this functions may be spread over other committees- as the Financial Risks or

Corporate Governance ones- however it is a point in which BPI does not specifically follows BIS recommendations.

BPI's governance, when compared to its peers, may have contributed to a different management- specially when taking into account recent scandals as BES or BCP in the past. The separation in 2004 between the Chairman and the CEO position is an example. Another example is the direct reporting of the Audit and Internal Committee to the Board of Directors and not to the Executive Committee, something that happens in BCP or happened in BES.

2. **How do you see the voting rights limits regarding good governance practices?**

Despite BPI's governance model appearing to be appropriate for this kind of institution, it violates one major principle of a good governance practice: the equivalence of one share to one voting right.

By imposing a cap on voting decisions, BPI does not allow one single shareholder to control the bank. We believe that this statutory condition is very related to the original shareholder base, which, because of its broad diversification, tried to give all shareholders (independent from its size) a say when deciding on major issues related to the firm's life. Moreover, it allowed the bank to remain immune to takeover attempts, as the one La Caixa tried to make. It also enabled that reference shareholders had an important say, however preventing them to control the firm and leaving some of their interests apart from BPI.

The issue with the model is that it works perfectly well when reference shareholders (as La Caixa and Santoro) have their interests synchronized. The best example for this were the peaceful times lived when the shareholder's trio (La Caixa, Allianz and Itau) held the majority of BPI's outstanding shares, allowing them to have strategic partnerships and protect their own interests without controlling the bank. On the other hand, when there is a significant change in reference shareholders' composition (as when Itau left the society's capital), their interests may no longer be aligned. As Santoro's major interest was to merge BPI with BCP while La Caixa wanted to gain the firm's control, the initial model that aimed to foster peace no longer worked, creating a big lock in the firm's life.

3. **Why is BFA a problem to the ECB and not for the BoP?**

One of the main risks related to the exposition of BPI to BFA is related to Angola's currency. The lack of liquidity of dollars or euros in Angola is known, meaning that the real exchange ratio from kwanzas is very different than the official one. Still, accounting rules determine that the exchange ratio for consolidation purposes (as the one made by BPI to BFA accounts) should be made at the official rate. Therefore, the real exposition that BPI has through BFA to assets as Angola Sovereign bonds is greater than the one accounted given the lack of liquidity to exchange kwanzas (the currency in which Angolan Sovereign debt tend to be issued).

Other key risks of Angola to BPI are related to the actual characteristics of the country. Being the country's GDP highly related to the price of oil, and given its volatility, the country tends to be severely affected when it is low, ultimately reflecting in its credit risk and affecting the holders of sovereign debt.

Still, when supervision switched from the BoP to the ECB, how may Angola started to be a problem for BPI? The answer may be related to a certain degree of bias that local regulators may have. In this case, the Portuguese connections to Angola are very long-dated, meaning that supervision criteria, namely when risk-weighting assets, tend to be more relaxed for local regulators than for central ones, as the ECB.

Another issue that is important to refer is related to the actual supervision rules. In this case, by loosing the controlling power of BFA (and earning an amount approximate to €130 million), BPI no longer has to consolidate all the accounts of BFA in its own and may start using a patrimonial equivalence accounting method. This also means that in exchange for €130 million, a €3 billion problem disappears. In other words, by reducing the risk in 5% (the BFA shares sold by BPI to Unitel), a capital buffer of €3 billion no longer needs to be raised, which somehow seems disproportionate. This demonstrates that regulatory models take preference in the "shape" over the "substance" of the assets being discussed in this case, meaning that these models are much based in accounting rules and not in the actual risks.

4. **Why does La Caixa launched the first tender offer knowing that the probability of success was reduced?**

La Caixa launched a tender offer on the 17th of February of 2015 aiming to own all BPI shares that it did not own yet. With a price of €1.329 (27,8% above its closing price of that day), the offer had a low success probability, given the conditions presented by the Spanish group in order for it to be successful. These included:

- The acquisition of at least 5,9% of the overall shares outstanding;
- The elimination of any shareholder voting rights limits.

The set of conditions presented had a clear purpose: assume the control of the bank. Since La Caixa already owned about 44% of BPI, it was time that it could control the Portuguese entity. While the first condition did not seem to complicate to achieve, being only dependent on the right price, when combined with the second the story was very different. Still, the main goal

of the tender offer was to show that from that point onwards BPI's major shareholder wanted a different path for the institution than the one it had follow until that moment.
Isabel dos Santos, facing this decision from La Caixa, first announced that she would propose a new merger between BPI and BCP, combining her interests in both firms. Given the low probability of such event occurring (taking into account the past of both institutions), this was considered by the public as a disguised way to say that she would be willing to sell but a significant higher price. The Angolan knew that, at that moment, she had a central role in resolving the problem. The reason was that the blocking mechanisms triggered by BPI's statutes gave her a pivotal role, even though she only owned less than 20% of the firm's equity. This condition, along with a controlling power in Unitel, gave her 100% of the solution, something she wanted to leverage in order to obtain a higher return than other shareholders in the reorganization process. Therefore, unless another solution was found (as raising €3 billion in capital that was deemed as impossible given the market conditions), she had the "cheese and the knife" on her hands, meaning that BPI's controlling power had a price- a trade-off between a €3 billion and a smaller amount that she could receive. This meant that, if returns were not unevenly distributed in her favour, Santoro could block the entire firm and create an even bigger problem.

5. **In your opinion, was BPI's board right when it issued a statement containing an unfavourable opinion and inviting remaining shareholders to decline the tender offer? What difficulties do you believe it may have felt?**

BPI's board, given its structure, had high influence from La Caixa due to the equity stake that the Spanish institution had in the Portuguese bank. For obvious reasons, representatives from La Caixa could not vote, however it could be anticipated that BPI's board could take the Spanish side of the problem, specially when taking into account that some administrators were appointed due to the confidence that La Caixa deposited on them (starting by the bank's CEO Fernando Ulrich). Also, La Caixa had always deposited its trust in the board.
By having the courage to issue a negative opinion about the tender offer, BPI's management board revealed above all independence from its reference shareholder, immunity to its pressures and care for smaller shareholders.

6. **What kind of solutions do you envisage for the problem?**

In order for Santoro to accept any solution, and because of Isabel dos Santos' pivotal role in the problem, there could be an asymmetric division of the returns of the tender offer.

The first solution would be to raise the €3 billion in capital. The problems related to this solution are mainly two. Firstly, and regarding the market conditions at that time, for a financial institution to raise that amount in capital in low interest rates times and with the condition of the Portuguese financial system, current shareholders that would not want to exercise their rights would see their equity stakes very reduced (given the needed devaluation in order to make the new shares attractive). Secondly, in operational terms, having to raise such amount of capital does not seem very attractive. This has to do with the fact that, on paper, Angola's operation seems very attractive. However, in a risk-adjusted basis, as for instance when taking into account currency risk, its attractiveness is reduced. When considering the trade-off between the devaluation of current shareholders shares and the profits arising from Angolan operations, in reality the capital raise does not seem very possible.

The second solution could comprise a review of the tender offer's price. By making it higher, La Caixa could make Santoro accept its conditions and concede the controlling power to the Spanish institution. While Santoro can accept it, La Caixa would have to spend much more money by paying all remaining shareholders the same amount.

Finally, another solution could be the previously referred asymmetric division of the price paid in the tender offer. This solution has the major inconvenient of jeopardising good governance rules, something that BPI always prided itself for. However, the main questions one should ask are: What is the monetary difference that the solution represent in the life of BPI? The answer is clear; €3 billion- the amount that BPI needs to raise in order to avoid sanctions of ECB due to its exposition to Angola. This solution would also have to entail a designated special independent committee to oversee the transaction, since they are transactions with related parties- not only the transaction between shareholders but also the payment that Unitel would have to make to BPI in order to assume the control of BFA. Thus, the committee would have to take into account the opportunity cost between good governance measures and the impact of a no solution in the life of BPI. Moreover, the committee would have to ensure that the BFA transaction is made at a fair value but that the situation is solved because of the costs involved. For instance, a member from Violas Financial was already complaining after the last shareholders meeting about this issue. Also, another issue relative to the case that should be comprised in the committee's set of actions would be the investigation of a €400 million loan conceded by La Caixa to the Republic of Angola- the details are not very known but should be subject to investigation beyond the one made by CMVM.